

Notes to the Condensed Consolidated Accounts

(Financial figures are expressed in Hong Kong dollars)

1. Basis of Preparation and Accounting Policies

These unaudited condensed consolidated interim accounts are prepared in accordance with Hong Kong Statement of Standard Accounting Practice (SSAP) 25, Interim Financial Reporting, issued by the Hong Kong Society of Accountants.

These condensed consolidated interim accounts should be read in conjunction with the 2001 annual accounts.

The accounting policies and methods of computation used in the preparation of these accounts are consistent with those used in the annual accounts for the year ended 31 December 2001 except as disclosed in notes 1 (a), 1 (b) and 1 (c) below.

(a) Associated companies

An associated company is a company, not being a subsidiary, in which an equity interest is held for the long-term and significant influence is exercised in its management.

Investments in associated companies are accounted for in the condensed consolidated accounts under the equity method. The condensed consolidated profit and loss account includes the Group's share of the results of associated companies for the period, and the condensed consolidated balance sheet includes the Group's share of the net assets of associated companies and goodwill (net of accumulated amortisation) on acquisition.

(b) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired company at the date of acquisition and is amortised on a straight-line basis over an estimated useful life not exceeding 20 years.

Where an indication of impairment exists, the carrying amount of goodwill is assessed and written down immediately to its recoverable amount.

(c) Employee benefit costs – equity compensation benefits

Share options are granted to Executive Directors and employees. When the options are exercised, the proceeds received net of any transaction costs are credited to share capital (nominal value) and share premium.



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2. Turnover

Turnover comprises trading fees, transaction levy and trading tariff from securities and options traded on The Stock Exchange of Hong Kong Limited (Stock Exchange) and derivatives contracts traded on Hong Kong Futures Exchange Limited (Futures Exchange), Stock Exchange listing fees, clearing and settlement fees, depository, custody and nominee services fees, income from sale of information, investment income (including investment income net of expenses of Clearing House Funds) and other income, which are disclosed as **Income** in the condensed consolidated profit and loss account.

3. Segment Information

The Group's income is derived solely from business activities in Hong Kong. An analysis of the Group's income and results for the period by business segments is as follows:

| | Six months ended 30 Jun 2002 (unaudited) | | | | | |
|--|--|-----------------------|----------------------|---------------|----------------|-----------------------|
| | \$'000 | | | | | |
| | Cash Market | Derivatives Market | Clearing Business | Others | Elimination | Group |
| Income | | | | | | |
| External | 474,245 | 77,260 | 202,687 | - | - | 754,192 |
| Inter-segment | 3,575 | - | 137 | - | (3,712) | - |
| Investment and other income | | | | | | |
| - segment | 2,539 | 41,259 | 13,101 | - | - | 56,899 |
| - unallocated | - | - | - | 82,099 | - | 82,099 |
| | 480,359 | 118,519 | 215,925 | 82,099 | (3,712) | 893,190 |
| Costs | | | | | | |
| | 195,596 | 60,714 | 119,423 | - | (1,230) | 374,503 |
| Segment results | <u>284,763</u> | <u>57,805</u> | <u>96,502</u> | <u>82,099</u> | <u>(2,482)</u> | <u>518,687</u> |
| Unallocated costs | | | | | | <u>202,651</u> |
| Profit before taxation | | | | | | 316,036 |
| Taxation | | | | | | <u>(26,145)</u> |
| Profit attributable to shareholders | | | | | | <u><u>289,891</u></u> |

Notes to the Condensed Consolidated Accounts

3. Segment Information (continued)

| | Six months ended 30 Jun 2001 (unaudited) | | | | | |
|--|--|-----------------------|----------------------|----------------|----------------|-----------------------|
| | \$'000 | | | | | |
| | Cash Market | Derivatives Market | Clearing Business | Others | Elimination | Group |
| Income | | | | | | |
| External | 489,762 | 74,415 | 227,748 | - | - | 791,925 |
| Inter-segment | 5,117 | - | 79 | - | (5,196) | - |
| Investment and other income | | | | | | |
| - segment | 2,761 | 63,674 | 32,276 | - | - | 98,711 |
| - unallocated | - | - | - | 110,571 | - | 110,571 |
| | 497,640 | 138,089 | 260,103 | 110,571 | (5,196) | 1,001,207 |
| Costs | 193,274 | 72,815 | 114,713 | - | (2,179) | 378,623 |
| Segment results | <u>304,366</u> | <u>65,274</u> | <u>145,390</u> | <u>110,571</u> | <u>(3,017)</u> | 622,584 |
| Unallocated costs | | | | | | <u>218,326</u> |
| Profit before taxation | | | | | | 404,258 |
| Taxation | | | | | | <u>(38,705)</u> |
| Profit attributable to shareholders | | | | | | <u><u>365,553</u></u> |



Notes to the Condensed Consolidated Accounts



3. Segment Information (continued)

The **Cash Market** business mainly refers to the operations of the Stock Exchange, which covers all products traded on the cash market platforms, such as equities, debt securities, unit trusts, warrants and rights. Currently, the Group operates two cash market platforms, the Main Board and the Growth Enterprise Market. The major sources of income of the business are trading fees, transaction levy, trading tariff, listing fees and income from sale of information.

The **Derivatives Market** business mainly refers to the derivatives products traded on the Futures Exchange and the Stock Exchange, which includes the provision and maintenance of trading platforms for a range of derivatives products, such as equity, currency and interest rate futures and options. Its income mainly comes from the trading fees imposed and the interest income on the margin funds received.

The **Clearing Business** refers mainly to the operations of Hong Kong Securities Clearing Company Limited (HKSCC), which is responsible for clearing, settlement and custodian activities and the related risk management of cash market activities. Its income is derived primarily from the fees charged on providing clearing, settlement, depository and nominee services.

Investment and other income under the **Others Segment** represents mainly investment income derived from corporate funds, which is not directly attributable to any of the three business segments and is therefore not allocated to the business segments. Unallocated costs represent overheads which are not directly attributable to the above-mentioned business segments.

Inter-segment transactions are conducted at arm's length.

4. Disposal of Subsidiary

On 31 May 2002, the share registration operations of the Group's Clearing Business, Hong Kong Registrars Limited (HKRL), a wholly owned subsidiary, were sold and merged with those of Central Registration Hong Kong Limited, which has been renamed as Computershare Hong Kong Investor Services Limited (CHIS). The Group received 18 per cent of the issued share capital of CHIS as consideration for the sale of HKRL. On the same date, the Group increased its holding in CHIS to 24 per cent by acquiring a further 6 per cent of the issued share capital of CHIS by cash.

Notes to the Condensed Consolidated Accounts

4. Disposal of Subsidiary (continued)

The results of HKRL for the five months ended 31 May 2002 have been incorporated in the condensed consolidated profit and loss account and are as follows:

| | Unaudited Five months ended 31 May 2002 \$'000 | Unaudited Six months ended 30 Jun 2001 \$'000 |
|------------------------|--|---|
| Income | 14,183 | 17,542 |
| Operating expenses | (2,509) | (4,537) |
| Profit before taxation | 11,674 | 13,005 |
| Taxation | (1,064) | (1,460) |
| Profit after taxation | <u>10,610</u> | <u>11,545</u> |

The net book value of the total assets and total liabilities of HKRL at the date of disposal was \$6,926,476 (31 December 2001: \$40,276,000) and \$6,926,456 (31 December 2001: \$8,084,000) respectively.

The disposal of HKRL for a 18 per cent holding in CHIS is considered an exchange of similar assets. As a result, no gain or loss arose from the transaction.

5. Trading Fees, Transaction Levy and Trading Tariff

| | Unaudited Six months ended 30 Jun | |
|---|---|----------------|
| | 2002 \$'000 | 2001 \$'000 |
| Trading fees, transaction levy and trading tariff are derived from: | | |
| Securities and options traded on the Stock Exchange | 116,350 | 145,571 |
| Derivatives contracts traded on the Futures Exchange | 50,582 | 48,152 |
| | <u>166,932</u> | <u>193,723</u> |



Notes to the Condensed Consolidated Accounts



6. Investment Income

| | Unaudited Six months ended 30 Jun | |
|---|---|----------------|
| | 2002 \$'000 | 2001 \$'000 |
| Interest income | | |
| Interest income | 147,285 | 253,754 |
| Interest expense | (2,466) | (54,286) |
| | 144,819 | 199,468 |
| Non-interest income | | |
| Net realised and unrealised losses on trading securities, dividends and exchange differences on investments | (9,811) | – |
| Total investment income | 135,008 | 199,468 |

7. Taxation

Taxation in the condensed consolidated profit and loss account represents:

| | Unaudited Six months ended 30 Jun | |
|--|---|----------------|
| | 2002 \$'000 | 2001 \$'000 |
| Provision for Hong Kong Profits Tax for the period | 32,932 | 37,119 |
| Overpayment in respect of prior years | (5,229) | – |
| | 27,703 | 37,119 |
| Deferred taxation | (1,558) | 1,586 |
| | 26,145 | 38,705 |

Hong Kong Profits Tax has been provided for at 16 per cent (2001: 16 per cent) on the estimated assessable profits for the period.

Notes to the Condensed Consolidated Accounts

8. Earnings Per Share

The calculation of basic earnings per share is based on the profit attributable to shareholders of \$289,891,000 (2001: \$365,553,000) and the weighted average of 1,041,861,730 shares (2001: 1,040,664,846) in issue during the six-month period.

The share options outstanding as set out in note 17 did not have a material dilutive effect on the basic earnings per share.

9. Fixed Assets

The Group is heavily reliant on the capability and reliability of its computer systems for its business operations, including those required for its electronic trading platforms and for post-trading clearing and settlement services. The total cost of additions to fixed assets of the Group during the six months to 30 June 2002 was \$81,591,000 (2001: \$128,536,000) of which \$66,494,000 (2001: \$86,898,000) or 81 per cent (2001: 68 per cent) was on computer systems, hardware and software.

10. Investments in Associated Companies

| | Unaudited at 30 Jun 2002 \$'000 | Audited at 31 Dec 2001 \$'000 |
|--|---------------------------------------|-------------------------------------|
| Share of net assets of associated companies | 2,780 | – |
| Goodwill on acquisition of shares in associated companies less amortisation (note a) | 26,925 | – |
| | 29,705 | – |
| Amounts due from associated companies (note b) | 12,532 | – |
| | 42,237 | – |

The Group's share of profit of the associated companies for the period amounted to \$601,000 and is included in **Other income** in the condensed consolidated profit and loss account.



Notes to the Condensed Consolidated Accounts

10. Investments in Associated Companies (continued)

a) Goodwill

| | \$'000 |
|--|---------------|
| Cost | |
| At 1 Jan 2002 | – |
| Addition on acquisition of shares in associated companies | 27,151 |
| At 30 Jun 2002 | <u>27,151</u> |
| Accumulated amortisation | |
| At 1 Jan 2002 | – |
| Charge for the period | 226 |
| At 30 Jun 2002 | <u>226</u> |
| Net book value | |
| At 30 Jun 2002 | <u>26,925</u> |
| At 31 Dec 2001 | <u>–</u> |

Notes to the Condensed Consolidated Accounts

10. Investments in Associated Companies (continued)

- b) Included in amounts due from associated companies are two loans. One loan of \$5,000,000 is unsecured, interest free and repayable on 30 September 2002. The other loan of \$7,500,000 is unsecured with interest payable semi-annually at prime rate per annum and is repayable on 31 May 2004.
- c) Details of the unlisted associated companies as at 30 June 2002 are as follows:

| Name | Place of incorporation | Principal activities | Particulars of shares held | Interest held |
|--|------------------------|--|----------------------------------|---------------|
| Computershare Hong Kong Investor Services Limited | Hong Kong | Provision of share registration services | 5,854 Class A ordinary shares | 24% |
| Wilco International Processing Services Limited | Hong Kong | Provision of transaction processing services to Stock Exchange Participants | 6 Class B ordinary shares | 30% |

Wilco International Processing Services Limited has an accounting year end of 30 June, which is not coterminous with the Group's accounting year end.



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11. Clearing House Funds

| | Unaudited at 30 Jun 2002 \$'000 | Audited at 31 Dec 2001 \$'000 |
|--|---------------------------------------|-------------------------------------|
| Net asset values of the Clearing House Funds are as follows: | | |
| HKSCC Guarantee Fund | 369,111 | 367,888 |
| SEOCH Reserve Fund | 131,511 | 128,837 |
| HKCC Reserve Fund | 445,455 | 447,429 |
| | 946,077 | 944,154 |
| Net assets of the Clearing House Funds are composed of: | | |
| Unlisted non-trading securities, at fair value | | |
| – debt securities | 180,994 | 340,821 |
| Contributions receivable from Broker | | |
| Participants in CCASS | 30,640 | 28,390 |
| Bank balances and time deposits | 750,085 | 590,304 |
| | 961,719 | 959,515 |
| Less: Accounts payable | (15,642) | (15,361) |
| | 946,077 | 944,154 |
| The Clearing House Funds are funded by: | | |
| Clearing Participants' contributions | 421,350 | 423,960 |
| Clearing houses' contributions | 320,200 | 320,200 |
| Accumulated investment income net of expenses attributable to: | | |
| – Clearing Participants' contributions | 161,989 | 157,975 |
| – Clearing houses' contributions | 42,538 | 42,019 |
| | 946,077 | 944,154 |

11. Clearing House Funds (continued)

The HKSCC Guarantee Fund provides resources to enable HKSCC to discharge the liabilities and obligations of defaulting Broker Participants in the Central Clearing and Settlement System (CCASS) arising from their Stock Exchange trades accepted for settlement on the Continuous Net Settlement (CNS) basis and defective securities deposited into CCASS. The SEOCH Reserve Fund and the HKCC Reserve Fund were established for the exclusive purpose of supporting The SEHK Options Clearing House Limited (SEOCH) and HKFE Clearing Corporation Limited (HKCC) to fulfil their counterparty obligations in the event that one or more of their Clearing Participants fail to meet their obligations to SEOCH and HKCC respectively.

12. Compensation Fund Reserve Account

The Securities and Futures Commission of Hong Kong (SFC) is responsible for maintaining the Unified Exchange Compensation Fund (Compensation Fund). The Stock Exchange is required by the Securities Ordinance (SO) to deposit with the SFC and keep deposited \$50,000 in respect of each Stock Exchange Trading Right in the Compensation Fund. The Stock Exchange maintains an account known as the Compensation Fund Reserve Account for all receipts and payments in relation to the Compensation Fund under the Rules of the Exchange, in particular the following:

- (a) The interest received from the SFC on the statutory deposits paid in respect of each Stock Exchange Trading Right into the Compensation Fund maintained by the SFC;
- (b) Amounts received or paid out in relation to each of the Stock Exchange Trading Rights granted or revoked by the Stock Exchange respectively; and
- (c) Amounts reserved for the replenishment to the Compensation Fund.

The Compensation Fund is further explained in note 24 (a).



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13. Cash and Derivatives Market Development Fund (CDMD Fund)

The CDMD Fund was established by the cash received from Hong Kong Futures Guarantee Corporation Limited (the former clearing house of the Futures Exchange) for the purpose of providing funding for the development and betterment of the cash and derivatives markets in Hong Kong.

14. Margin Funds on Derivatives Contracts

| | Unaudited at 30 Jun 2002 \$'000 | Audited at 31 Dec 2001 \$'000 |
|---|---------------------------------------|-------------------------------------|
| The margin funds comprise: | | |
| SEOCH Clearing Participants' margin funds | 672,631 | 740,934 |
| HKCC Clearing Participants' margin funds | 4,149,492 | 4,062,173 |
| | <u>4,822,123</u> | <u>4,803,107</u> |
| The assets of the margin funds comprise: | | |
| Bank balances and time deposits | 2,622,054 | 2,339,051 |
| Listed securities deposited as alternatives to cash deposits, at market value | 1,068,835 | 1,312,995 |
| Listed non-trading securities, at fair value | | |
| – debt securities | – | 68,208 |
| Unlisted non-trading securities, at fair value | | |
| – money market fund | 293,548 | 229,127 |
| – debt securities | 837,686 | 853,726 |
| | <u>4,822,123</u> | <u>4,803,107</u> |
| The Group's liabilities in respect of the margin funds are as follows: | | |
| Margin deposits and securities received from SEOCH and HKCC Participants on derivatives contracts | <u>4,822,123</u> | <u>4,803,107</u> |

Notes to the Condensed Consolidated Accounts

15. Accounts Receivable, Prepayments and Deposits/Accounts Payable, Accruals and Other Liabilities

The Group's accounts receivable, prepayments and deposits and accounts payable, accruals and other liabilities amounted to \$2,227,610,000 (31 December 2001: \$2,334,767,000) and \$2,469,870,000 (31 December 2001: \$2,733,306,000) respectively. These mainly represent the Group's CNS money obligations under the T+2 settlement cycle. The Group's CNS money obligations receivable represent 77 per cent (31 December 2001: 74 per cent) of the total accounts receivable, prepayments and deposits. CNS money obligations payable represent 70 per cent (31 December 2001: 61 per cent) of the total accounts payable, accruals and other liabilities. CNS money obligations mature within two days as they are due for settlement two days after the trade date. The majority of the remaining accounts receivable, prepayments, deposits, accounts payable, accruals and other liabilities will mature within three months.

16. Provisions

| | Reinstatement costs \$'000 | Employee benefit costs \$'000 | Total \$'000 |
|-------------------------------|----------------------------------|-------------------------------------|-----------------|
| At 1 Jan 2002 | 31,243 | 23,826 | 55,069 |
| Provision for the period | - | 16,129 | 16,129 |
| Reversal of overprovision | (155) | - | (155) |
| Amount used during the period | - | (14,795) | (14,795) |
| Amount paid during the period | - | (1,334) | (1,334) |
| At 30 Jun 2002 | 31,088 | 23,826 | 54,914 |

| | Unaudited at 30 Jun 2002 \$'000 | Audited at 31 Dec 2001 \$'000 |
|-------------------------|---------------------------------------|-------------------------------------|
| Analysis of provisions: | | |
| Current | 25,772 | 25,927 |
| Non-current | 29,142 | 29,142 |
| | 54,914 | 55,069 |



Notes to the Condensed Consolidated Accounts

17. Share Capital and Share Premium



| | Unaudited at 30 Jun 2002 \$'000 | Audited at 31 Dec 2001 \$'000 |
|---|---------------------------------------|-------------------------------------|
| Authorised: 2,000,000,000 shares of \$1 each | <u>2,000,000</u> | <u>2,000,000</u> |

Issued and fully paid:

| | No. of shares | Share capital \$'000 | Share premium \$'000 | Total \$'000 |
|--|----------------------|----------------------------|----------------------------|------------------|
| At 1 Jan and 31 Dec 2001 | 1,040,664,846 | 1,040,665 | – | 1,040,665 |
| Shares issued under share option scheme | <u>2,462,000</u> | <u>2,462</u> | <u>16,052</u> | <u>18,514</u> |
| At 30 Jun 2002 | <u>1,043,126,846</u> | <u>1,043,127</u> | <u>16,052</u> | <u>1,059,179</u> |

Under the Pre-Listing Share Option Scheme of HKEx, share options were granted to employees on 20 June 2000 which are exercisable between 6 March 2002 and 30 May 2010 at an exercise price of \$7.52 per share.

During the period, options were exercised to subscribe for 2,462,000 shares (2001: Nil) in HKEx at a consideration of \$7.52 per share, of which \$1.00 per share was credited to share capital and the balance of \$6.52 per share was credited to the share premium account.

Movements of the share options during the period were as follows:

| Number of shares issuable under the share options outstanding as at 1 Jan 2002 | Number of share options forfeited | Number of share options granted | Number of share options exercised | Number of shares issuable under the share options outstanding as at 30 Jun 2002 |
|---|--|--|--|---|
| 27,267,384 | (790,464) | – | (2,462,000) | 24,014,920 |

Notes to the Condensed Consolidated Accounts

18. Revaluation Reserves

| | Unaudited at 30 Jun 2002 \$'000 | Audited at 31 Dec 2001 \$'000 |
|---|---------------------------------------|-------------------------------------|
| Investment properties revaluation reserve | 1,771 | 3,271 |
| Other properties revaluation reserve | 25,388 | 33,633 |
| Investment revaluation reserve | 12,025 | 6,893 |
| | 39,184 | 43,797 |

The revaluation reserves are segregated for their respective specific purposes.

19. Designated Reserves

| | Unaudited at 30 Jun 2002 \$'000 | Audited at 31 Dec 2001 \$'000 |
|---|---------------------------------------|-------------------------------------|
| Clearing House Funds reserves | | |
| – HKSCC Guarantee Fund reserve | 255,261 | 254,428 |
| – SEOCH Reserve Fund reserve | 46,012 | 44,837 |
| – HKCC Reserve Fund reserve | 223,454 | 220,929 |
| | 524,727 | 520,194 |
| Compensation Fund Reserve Account reserve | 35,505 | 35,146 |
| CDMD Fund reserve | 914 | 914 |
| Development reserves | | |
| – the Stock Exchange | 135,762 | 135,762 |
| | 696,908 | 692,016 |

These reserves are segregated for their specific purposes.



Notes to the Condensed Consolidated Accounts

20. Retained Earnings

| | Unaudited at 30 Jun 2002 \$'000 | Audited at 31 Dec 2001 \$'000 |
|--|---------------------------------------|-------------------------------------|
| At 1 Jan | 3,458,929 | 2,851,834 |
| Profit for the period/year | 289,891 | 740,426 |
| Investment income net of expenses of Clearing House Funds transferred to Clearing House Funds reserves | (4,533) | (46,039) |
| Investment income net of expenses of Compensation Fund Reserve Account transferred to Compensation Fund Reserve Account reserve | (359) | (4,039) |
| 2001 final/interim dividend | (260,166) | (83,253) |
| Dividend on shares issued for share options exercised after declaration of 2001 final dividend | (448) | - |
| At 30 Jun/31 Dec | <u>3,483,314</u> | <u>3,458,929</u> |
| Representing: | | |
| Retained earnings at 30 Jun/31 Dec | 3,399,864 | 3,198,763 |
| Proposed interim/final dividend | 83,450 | 260,166 |
| At 30 Jun/31 Dec | <u>3,483,314</u> | <u>3,458,929</u> |

Notes to the Condensed Consolidated Accounts

21. Notes to the Condensed Consolidated Cash Flow Statement

| | Unaudited | |
|--|-------------------------|------------------|
| | Six months ended 30 Jun | |
| | 2002 | 2001 |
| | \$'000 | \$'000 |
| (a) Analysis of cash and cash equivalents | | |
| Time deposits with original maturity within three months | 668,221 | 2,887,503 |
| Cash at bank and in hand | 76,969 | 306,656 |
| Cash and cash equivalents at 30 Jun | 745,190 | 3,194,159 |

(b) The net assets in Clearing House Funds, Compensation Fund Reserve Account, CDMD Fund and margin funds are held in segregated accounts for specific purposes. Movements in individual items of the net assets of the funds during the period therefore do not constitute any cash or cash equivalent transactions to the Group except for the investment income net of expenses of these funds which has been accounted for as the Group's assets and profit.

(c) Following the adoption of SSAP 15, Cash Flow Statements (revised December 2001), certain comparatives previously reported have been restated to conform to the new policy.

22. Commitments

| | Unaudited at 30 Jun 2002 | Audited at 31 Dec 2001 |
|--|-----------------------------|---------------------------|
| | \$'000 | \$'000 |
| Commitments in respect of capital expenditure: | | |
| Contracted but not provided for | 65,915 | 50,194 |
| Authorised but not contracted for | 191,322 | 267,199 |
| | 257,237 | 317,393 |

The commitments in respect of capital expenditure were mainly for the development and purchases of computer systems.





23. Financial Risk Management

When seeking to optimise returns on its funds available for investment, the Group may invest in non-HKD securities from time to time. Forward foreign exchange contracts are used to hedge the currency exposures of the Group's non-HKD investments to mitigate risks arising from fluctuations in exchange rates. As at 30 June 2002, the total nominal value of outstanding forward foreign exchange contracts amounted to HK\$253 million (31 December 2001: HK\$120 million). All contracts will mature within three months.

24. Contingent Liabilities

- (a) The Compensation Fund is a fund set up under the SO for the purpose of compensating any person dealing with a Stock Exchange Participant (other than another Stock Exchange Participant) for any pecuniary losses suffered as a result of defaults of the Stock Exchange Participant. According to section 109(3) of the SO, the maximum compensation amount is \$8 million for each Stock Exchange Participant's default. Under section 113(5A) of the SO, the Stock Exchange may, upon satisfying certain conditions, with the approval of the SFC, allow an additional payment to the successful claimants before apportionment. Under section 107(1) of the SO, the Stock Exchange has contingent liabilities to the Compensation Fund as it shall replenish the Compensation Fund upon the SFC's request to do so. The amounts to be replenished should be equal to the amount paid in connection with the satisfaction of the claims, including any legal and other expenses paid or incurred in relation to the claims but capped at \$8 million per default. As at 30 June 2002, there were outstanding claims received in respect of 14 defaulted Stock Exchange Participants (31 December 2001: 15).

Under the new investor compensation arrangements to be implemented under the Securities and Futures Ordinance (SFO) enacted in March 2002, a new single Investor Compensation Fund would replace the existing Compensation Fund, the Commodity Exchange Compensation Fund and the Dealers' Deposit Schemes for non-exchange participant dealers. The new arrangements would eliminate the existing requirement for Exchange Participants and non-exchange participant dealers to make deposits to the Compensation Funds and Dealers' Deposit Schemes respectively. Existing deposits would be returned to the Stock Exchange and the Futures Exchange and to non-exchange participant dealers in accordance with the provisions of the SFO. The arrangements would also remove the existing requirement for the Stock Exchange to replenish the Compensation Fund. The SFO will come into effect on a date to be announced.

24. Contingent Liabilities (continued)

- (b) The Stock Exchange has undertaken to indemnify the Collector of Stamp Revenue against any loss of revenue resulting from any underpayment or default or delay in payment of stamp duty by its Participants, up to \$200,000 in respect of defaults of any one Participant. In the unlikely event that all of its 481 trading Participants as at 30 June 2002 (31 December 2001: 492) default, the maximum contingent liability of the Stock Exchange under the indemnity will amount to \$96 million (31 December 2001: \$98 million).
- (c) Pursuant to Section 21 of the Exchanges and Clearing Houses (Merger) Ordinance, HKEx gave an undertaking on 6 March 2000 in favour of HKSCC to contribute an amount not exceeding \$50 million in the event of HKSCC being wound up while it is a wholly owned subsidiary of HKEx or within one year after HKSCC ceases to be a wholly owned subsidiary of HKEx, for payment of the debts and liabilities of HKSCC contracted before HKSCC ceases to be a wholly owned subsidiary of HKEx, and for the costs, charges and expenses of winding up.

25. Material Related Party Transactions

Certain Directors of HKEx are directors and/or shareholders of (i) Stock Exchange Participants and Futures Exchange Participants (Exchange Participants) and Clearing Participants; (ii) companies listed on the Stock Exchange; and (iii) buy-in brokers. Securities and derivatives contracts traded by, and fees levied on, these Exchange Participants and Clearing Participants, fees levied on these listed companies and fees paid to these buy-in brokers are all undertaken in the ordinary course of business of the Group on the standard terms and conditions applicable to all other Exchange Participants and Clearing Participants, listed companies and buy-in brokers.



Notes to the Condensed Consolidated Accounts



26. Off Balance Sheet Risks

In the normal course of business, the clearing houses of the Group, HKSCC, SEOCH and HKCC, act as the counterparties to eligible trades concluded on the Stock Exchange and the Futures Exchange through the novation of the obligations of the buyers and sellers. HKSCC is also responsible for the good title to the securities deposited and accepted in the CCASS depository. As a result, the Group has considerable market risk and credit risk since the Participants' ability to honour their obligations in respect of their trades and securities deposited may be adversely impacted by economic conditions affecting the cash and derivatives markets. If the Participants default on their obligations on settlement or there are defects in the title of securities deposited and accepted in the CCASS depository, the Group could be exposed to potential risks not otherwise accounted for in these condensed consolidated interim accounts.

The Group mitigates its exposure to the risks described above by requiring the Participants to meet the Group's established financial requirements and criteria for admission as Participants, monitoring compliance with risk management measures such as position limits established by the Group and requiring Clearing Participants to contribute to the Clearing House Funds set up by HKSCC, SEOCH and HKCC. HKSCC also retains recourse against those Participants whose securities are deposited and accepted in the CCASS depository. Moreover, insurance has been taken out by the Group to cover the risks.

27. Charges on Assets

As at 31 December 2001, the Group had a \$10 million overdraft facility with a bank in Hong Kong, which was secured by a pledge of the Group's time deposits of an equivalent amount at that bank. This overdraft facility was not utilised and was terminated during the period. The Group did not have any charges on assets as at 30 June 2002.